

UNITED STATES DISTRICT COURT
DISTRICT OF NEVADA

THE FIRST NATIONAL BANK OF ELY,)

Plaintiff,)

v.)

PROGRESSIVE CASUALTY INSURANCE)
COMPANY, ABA INSURANCE SERVICES,)
DOES I through X, inclusive,)

Defendants.)

3:11-cv-00859-RCJ-WGC

ORDER

This case involves contractual, statutory, and tort claims by an insured bank against its insurer. Currently before the Court is a motion to dismiss for failure to state a claim, and in the alternative, to strike certain relief requested (#23) and a motion to strike new defenses and for leave to file second amended complaint (#30).

BACKGROUND

First National Bank of Ely ("First National") is a nationally chartered bank operating in the state of Nevada. (First Am. Compl. (#22) at 1). First National obtained two types of insurance coverage through Defendant Progressive Casualty Insurance Company ("Progressive"). (*Id.* at 4-5). The first was a fidelity bond policy (the "Bond") with policy number 7107559-05. (*Id.* at 4). The second was a directors and officers policy of insurance (the "D&O Policy") with policy number 4549014-05. (*Id.* at 5). ABA Insurance Services ("ABAIS") served as Progressive's agent for claim investigation and administration of the Bond and D&O Policy. (*Id.* at 2).

On or about November 23, 2009, First National became aware of a loss caused by Mr. Stephen Marich, an employee and officer of First National, who embezzled money belonging

1 to depositors of First National and/or First National itself. (*Id.* at 5). Marich later pled guilty to
2 embezzlement and was sentenced to imprisonment and ordered to pay restitution of
3 \$5,897,234.98. (*Id.* at 6; *United States v. Marich*, No. 2:11-cr-43-KJD-RJJ, Doc. ##6, 14).
4 First National then timely notified Progressive and ABAIS of the loss caused by Marich's
5 actions, for which First National was legally responsible, and requested coverage and
6 indemnification for the loss. (First Am. Compl. (#22) at 5-7).

7 Otto Elkins, a claim investigator and claim adjuster for ABAIS, commenced an
8 investigation of First National's claim for benefits. (*Id.* at 7). On September 28, 2010, Elkins
9 told John Gianoli, President of First National, and Joy Graber, prior counsel for the bank, that
10 benefits would not be payable on the D&O Policy until a lawsuit was filed against the bank as
11 a result of Marich's conduct. (*Id.* at 11-12). Elkins then repeated this information to Gianoli
12 in September 2010 and to Graber on May 13, 2010 and in May 2011. (*Id.* at 12). This
13 information was allegedly false and was made for the purported purpose of refusing to pay
14 First National for its loss under the Bond and D&O Policy so that ABAIS and Progressive could
15 profit thereby. (*Id.* at 8).

16 After investigating the claim, Progressive paid First National only \$1,547,318.08 of the
17 \$1,675,000 available under the Bond. (*Id.* at 8; April 4, 2011 Letter (#30-15) at 5). Elkins
18 noted in a letter dated April 4, 2011 that the full value of benefits under the Bond were not paid
19 because of a material misrepresentation made by the bank and because a bank employee
20 discovered Marich's suspicious activities but did nothing about them, and therefore the losses
21 suffered after this discovery were not covered by the bond. (First Am. Compl. (#22) at 8; April
22 4, 2011 Letter (#30-15) at 6-8). Progressive also did not pay First National any of the benefits
23 available under the D&O Policy because, as stated in a letter from Elkins dated May 31, 2011,
24 no suits had been filed or demands made against the bank. (First Am. Compl. (#22) at 8; May
25 31, 2011 Letter (#30-17) at 2-4). Defendants reserved all rights to assert additional defenses
26 in the future in both letters. (April 4, 2011 Letter (#30-15) at 8; May 31, 2011 Letter (#30-17)
27 at 4).

28 First National filed a complaint in Nevada state court on October 25, 2011 against

1 Progressive, ABAIS, and American Bankers Association Insurance Company (Progressive's
2 reinsurer). (Compl. (#1-4) at 6-7). The complaint was then removed to this Court by
3 Progressive and ABAIS on November 28, 2011. (Pet. for Removal (#1)).

4 First National then filed a first amended complaint on February 17, 2012 against only
5 Progressive and ABAIS (collectively "Defendants"). (First Am. Compl. (#22) at 1). The first
6 amended complaint contains five causes of action, including: (1) breach of contract; (2) breach
7 of the covenant of good faith and fair dealing; (3) violation of the Nevada Unfair Claims
8 Settlement Practices Act; (4) fraud and concealment; and (5) negligence. (*Id.* at 9-17).

9 On March 14, 2012, Progressive filed a motion to dismiss, and in the alternative, a
10 motion to strike certain relief requested. (Mot. to Dismiss & Strike (#23)). Specifically,
11 Progressive seeks to dismiss the first amended complaint for failure to state a claim, and in
12 the alternative, strike First National's request for punitive damages, claiming First National has
13 failed to plead facts showing Progressive acted with oppression, malice, or fraud. (*Id.* at 2, 15-
14 16).

15 On July 2, 2012, First National filed a motion to strike new defenses asserted by
16 Progressive and for leave to file a second amended complaint. (Mot. to Strike & Amend
17 (#30)). First National claims Progressive is asserting new defenses as to why coverage under
18 the insurance contracts was denied which were not asserted in its denial letters and that these
19 new defenses should be stricken. (*Id.* at 10-15). First National also seeks leave to file a
20 second amended complaint, asserting that after filing the first amended complaint it became
21 aware that a claim was asserted by shareholders in a derivative capacity on behalf of First
22 National against the bank's president, John Gianoli. (*Id.* at 15-16).

23 **MOTION TO DISMISS AND TO STRIKE (#23)**

24 **A. Legal Standard**

25 The purpose of a Rule 12(b)(6) motion to dismiss for failure to state a claim is to test the
26 legal sufficiency of a complaint. *Navarro v. Block*, 250 F.3d 729, 732 (9th Cir. 2001). "[T]he
27 issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer
28 evidence to support the claims." *Gilligan v. Jamco Dev. Corp.*, 108 F.3d 246, 249 (9th Cir.

1 1997) (quoting *Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974)).

2 To avoid a Rule 12(b)(6) dismissal, a complaint must plead “enough facts to state a
3 claim to relief that is plausible on its face.” *Clemens v. DaimlerChrysler Corp.*, 534 F.3d 1017,
4 1022 (9th Cir. 2008) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). A claim
5 is plausible on its face “when the plaintiff pleads factual content that allows the court to draw
6 the reasonable inference that the defendant is liable for the misconduct alleged.” *Ashcroft v.*
7 *Iqbal*, 556 U.S. 662, 678 (2009). Although detailed factual allegations are not required, the
8 factual allegations “must be enough to raise a right to relief above the speculative level.”
9 *Twombly*, 550 U.S. at 555. “A pleading that offers ‘labels and conclusions’ or ‘a formulaic
10 recitation of the elements of a cause of action will not do,’ ” nor will “‘naked assertions’ devoid
11 of ‘further factual enhancement.’ ” *Iqbal*, 556 U.S. at 678 (quoting *Twombly*, 550 U.S. at 555,
12 557). All well-pleaded factual allegations will be accepted as true and all reasonable
13 inferences that may be drawn from the allegations must be construed in the light most
14 favorable to the nonmoving party. *Broam v. Bogan*, 320 F.3d 1023, 1028 (9th Cir. 2003).

15 If the court grants a motion to dismiss a complaint, it must then decide whether to grant
16 leave to amend. The court should freely give leave to amend when there is no “undue delay,
17 bad faith or dilatory motive on the part of the movant, . . . undue prejudice to the opposing
18 party by virtue of allowance of the amendment, [or] futility of amendment.” *Foman v. Davis*,
19 371 U.S. 178, 182 (1962); see also FED. R. CIV. P. 15(a). Generally, leave to amend is only
20 denied when it is clear that the deficiencies of the complaint cannot be cured by amendment.
21 *DeSoto v. Yellow Freight Sys., Inc.*, 957 F.2d 655, 658 (9th Cir. 1992).

22 **B. Discussion**

23 **1. Breach of Contract**

24 In the first cause of action, First National claims Progressive breached the Bond and
25 D&O Policy contracts by failing to interpret the Bond and D&O Policy agreements broadly, by
26 failing to construe these contracts fairly, and by delaying and refusing to pay First National’s
27 claim. (First Am. Compl. at 9). To succeed on a breach of contract claim, the plaintiff must
28 demonstrate: (1) formation of a valid contract; (2) breach by the defendant; and (3) damages

1 resulting from the breach. *Saini v. Int'l Game Tech.*, 434 F.Supp.2d 913, 919-20 (D. Nev.
2 2006) (citing *Richardson v. Jones*, 1 Nev. 405, 405 (1865)).

3 As for the Bond, First National has alleged that a valid contractual agreement existed.
4 (First Am. Compl. (#22) at 9). The first amended complaint states that Progressive breached
5 the Bond agreement by not paying the full amount due under the Bond. (*Id.*). First National
6 has also alleged that it was damaged by the breach because it was not compensated for its
7 loss to the extent required by the Bond. (*Id.*). Progressive has not shown that it was legally
8 justified in denying the full amount available under the Bond in its motion to dismiss. First
9 National has accordingly stated a claim for breach of the Bond agreement.

10 However, First National has failed to state a claim for breach of the D&O Policy.
11 Although a contractual relationship did exist between the parties in the form of the D&O Policy
12 agreement, First National has failed to properly plead facts indicating that Progressive
13 breached the agreement. The D&O Policy states that Progressive is required to reimburse
14 First National for "Loss resulting from Claims first made during the Policy Period or the
15 Discovery Period against the Insured Persons for which the Company has agreed to or is
16 legally permitted or required by law to indemnify the Insured Persons for Wrongful Acts."
17 (D&O Policy (#23-3) at 5).¹ The D&O Policy also requires Progressive to reimburse First
18 National for "Loss resulting from Claims first made during the Policy Period or the Discovery
19 Period against the Company for which the Company is legally obligated to pay for Wrongful
20 Acts." (*Id.*). Both of these provisions provide that Progressive is not required to reimburse

21
22
23 ¹ The first amended complaint specifically refers to the D&O Policy and the parties have
24 requested that the Court take judicial notice of this agreement. (First Am. Compl. (#22) at 9;
25 Mot. to Dismiss & Strike (#23) at 4; Mot. to Strike & Amend (#30) at 2). Accordingly, the Court
26 may consider the D&O Policy on a motion to dismiss without converting the motion into a
27 motion for summary judgment. See *In re Stac Electronics Securities Litigation*, 89 F.3d 1399,
28 1405 n.4 (9th Cir. 1996) ("Documents whose contents are alleged in a complaint and whose
authenticity no party questions, but which are not physically attached to the pleading, may be
considered in ruling on a Rule 12(b)(6) motion to dismiss.") (internal quotation marks and
brackets omitted); *Branch v. Tunnell*, 14 F.3d 449, 454 (9th Cir.1994) ("[D]ocuments whose
contents are alleged in a complaint . . . , but which are not physically attached to the pleading,
may be considered in ruling on a Rule 12(b)(6) motion to dismiss."), *overruled on other
grounds by Galbraith v. Cnty. of Santa Clara*, 307 F.3d 1119 (9th Cir. 2002).

1 First National unless First National first either indemnifies an insured person or the company
2 was legally obligated to pay another party for a wrongful act. *See also Pan Pac. Retail*
3 *Properties, Inc., v. Gulf Ins. Co.*, 471 F.3d 961, 972 (9th Cir. 2006) (there is no company
4 indemnification coverage where a company has not paid indemnity to its directors or officers).
5 The first amended complaint nowhere states that First National indemnified Marich or any
6 other individual for Marich's wrongful conduct. The first amended complaint also fails to state
7 that First National paid out funds it was legally obligated to pay due to the wrongful acts.
8 Based on the facts alleged, it appears First National seeks to simply be compensated for the
9 losses it suffered through Marich's embezzlement rather than be reimbursed for money paid
10 or indemnification made. The D&O Policy however does not cover any loss First National
11 suffers, but rather explicitly only covers indemnification and company liability. (D&O Policy
12 (#23-3) at 5). As First National has failed to allege that it indemnified an insured person for
13 a wrongful act or that it was legally obligated to pay funds due to a wrongful act, First National
14 has failed to sufficiently allege a breach of the D&O Policy by Progressive.

15 Furthermore, Progressive did not breach the D&O Policy because the policy does not
16 compensate First National for the loss suffered from fraudulent and criminal conduct. The
17 Fraud/Violation of Law Exclusion contained in the D&O Policy states "[t]he Insurer shall not
18 be liable to make any payment for Loss, other than Defense Costs, in connection with any
19 Claim arising out of or in any way involving any fraudulent, dishonest or criminal act . . . by the
20 Insured, provided a final judgment or final adjudication establishes such fraudulent, dishonest,
21 or criminal act." (*Id.* at 12). "Insured" is defined in the D&O Policy as either First National or
22 an "Insured Person," meaning any past, present or future director, officer, or employee of the
23 company. (*Id.* at 8).

24 First National admits in its first amended complaint that Marich committed a fraudulent,
25 dishonest, and criminal act. (First Am. Compl. (#22) at 6). The first amended complaint also
26 alleges that Marich pled guilty and was sentenced for a criminal act which involved fraud and
27 dishonesty, and thus a final judgment was issued establishing the fraudulent, dishonest, and
28 criminal act. (*Id.*; *see also United States v. Marich*, No. 2:11-cr-43-KJD-RJJ, Doc. ##6, 14).

1 First National also does not claim it defended Marich and incurred costs in doing so, but rather
2 seeks to be compensated for the loss itself. Because the loss resulted from a fraudulent,
3 dishonest, and criminal act, Progressive is not responsible for compensating First National for
4 the loss under the terms of the D&O Policy and accordingly did not breach the policy by failing
5 to do so.

6 **2. Breach of the Covenant of Good Faith and Fair Dealing**

7 First National alleges in the second cause of action that Progressive breached the
8 covenant of good faith and fair dealing. (First Am. Compl. (#22) at 9-10). Nevada law holds
9 that “[e]very contract imposes upon each party a duty of good faith and fair dealing in its
10 performance and its enforcement.” *A.C. Shaw Constr. v. Washoe Cnty.*, 784 P.2d 9, 9 (Nev.
11 1989) (quoting RESTATEMENT (SECOND) OF CONTRACTS § 205). To succeed on a cause of
12 action for breach of the covenant of good faith and fair dealing, a plaintiff must show: (1) the
13 plaintiff and defendant were parties to an agreement; (2) the defendant owed a duty of good
14 faith to the plaintiff; (3) the defendant breached that duty by performing in a manner that was
15 unfaithful to the purpose of the contract; and (4) the plaintiff’s justified expectations were
16 denied. *Perry v. Jordan*, 900 P.2d 335, 338 (Nev. 1995).

17 First National has alleged that Progressive and First National were parties to an
18 agreement—the Bond and D&O Policy—and that Progressive owed First National a duty of
19 good faith. (First Am. Compl. (#22) at 4-5, 9). First National has also alleged that Progressive
20 breached that duty by failing to pay the Bond and D&O Policy claim, failing to conduct a
21 prompt and objective evaluation of the claim, and by misrepresenting facts and unreasonably
22 interpreting the insurance contracts. (*Id.* at 9-10). Progressive failed to pay the full amount
23 due under the Bond—which covered the loss suffered—and failed to conduct a prompt
24 investigation of the claim, thereby denying First National its justifiable expectations in being
25 compensated to the full extent allowed by the agreement. Although Progressive did not have
26 a duty to pay under the D&O Policy, it did have a responsibility to conduct a prompt evaluation
27 of the claim and to not misrepresent the terms of the policy to First National. As First National
28 has alleged that Progressive failed to pay the full amount owed under the Bond, unreasonably

1 delayed and misrepresented the nature of the insurance contracts in a manner that was
2 unfaithful to the purpose of the contracts, and denied First National its justified expectation in
3 prompt acceptance and payment on the claims, First National has adequately stated a claim
4 for breach of the covenant of good faith and fair dealing.

5 **3. Breach of the Nevada Fair Claims Settlement Practices Act**

6 In the third cause of action, First National asserts that Progressive violated the Nevada
7 Unfair Claims Settlement Practice Act by: (1) misrepresenting the true nature of the benefits
8 of the insurance contracts; (2) failing to engage in prompt and fair handling of the claims; (3)
9 failing to implement reasonable standards for the prompt investigation and processing of
10 claims; (4) failing to conduct a prompt, fair, and thorough investigation of the claims; and (5)
11 failing to promptly effectuate a fair and equitable settlement of the claims. (First Am. Compl.
12 (#22) at 11). The purpose of NRS §§ 686A.010 to 686A.310, inclusive, is to regulate the
13 business practices of insurance. NEV. REV. STAT. § 686A.010. NRS § 686A.310(1) includes
14 sixteen subsections, each defining an activity to be an unfair insurance practice. A private
15 right of action exists to sue for damages suffered from a violation of any one of these sixteen
16 subsections. NEV. REV. STAT. § 686A.310(2).

17 Subsection (1)(a) makes it a violation to “[m]isrepresent[] to insureds or claimants
18 pertinent facts or insurance policy provisions relating to any coverage at issue.” NEV. REV.
19 STAT. § 686A.310(1)(a). First National has alleged that Elkins of ABAIS informed Gianoli and
20 Graber of First National on September 28, 2010 that benefits would not be paid under the
21 D&O Policy unless a lawsuit was filed against the bank as a result of Marich’s wrongful
22 conduct. (First Am. Compl. (#22) at 11-12). Elkins again made these same representations
23 to Graber on May 13, 2010 and in May 2011, and to Gianoli again sometime in September
24 2010. (*Id.* at 12). First National alleges that these statements were false because the D&O
25 Policy defines a claim as “a written or oral demand for monetary damages or non-monetary
26 relief” in addition to a civil or criminal proceeding. (D&O Policy (#23-3) at 7). Progressive
27 argues that even if it misrepresented the D&O Policy on these earlier dates, that in the May
28 31, 2011 letter to First National Elkins properly stated that a written or oral demand for

1 monetary damages or non-monetary relief constitutes a claim, and therefore Progressive did
2 not misrepresent the terms of the policy. (Mot. to Dismiss & Strike (#23) at 12). However, the
3 fact that Progressive correctly stated the terms of the Policy in May 2011 does not change the
4 fact that Progressive may have misstated the terms of the policy on numerous other occasions
5 before it was corrected in the letter. Accordingly, First National has stated a claim for relief
6 under NRS § 686A.310(1)(a).

7 Subsections (1)(b)-1(e) make it a violation to fail to act reasonably promptly upon
8 communications with respect to claims, fail to implement reasonable standards for the prompt
9 investigation of claims, fail to affirm or deny coverage within a reasonable time after the proof
10 of loss requirements have been submitted, and to fail to effectuate prompt, fair and equitable
11 settlements of claims in which liability of the insurer has become reasonably clear. NEV. REV.
12 STAT. §§ 686A.310(1)(b)-(e). The first amended complaint alleges that First National became
13 aware of the loss in November 23, 2009 and timely notified Progressive of the loss. (First Am.
14 Compl. (#22) at 5). First National was never instructed by Progressive that its claims under
15 the Bond or D&O Policy were incomplete or that additional information was required. (*Id.* at
16 11). Yet despite allegedly having all the relevant information, Progressive did not affirm or
17 deny coverage and provide its reasons for doing so until April 4, 2011 for the Bond and until
18 May 31, 2011 for the D&O Policy. (*Id.* at 8). As First National has alleged that it took
19 Progressive nearly a year and a half to fully address its claims, First National has stated a
20 claim for relief under NRS §§ 686A.310(1)(b)-(e).

21 First National also argues that Progressive violated certain provisions of Chapter 686A
22 of the Nevada Administrative Code. However, the Nevada Supreme Court has held that while
23 failure to pursue an administrative violation with Nevada Department of Insurance (“NDOI”)
24 does not preclude subject matter jurisdiction in the district courts, it does render the claim
25 unripe and therefore “nonjusticiable.” *Allstate Ins. Co. v. Thorpe*, 170 P.3d 989, 993-94 (Nev.
26 2007). In *Thorpe*, the Nevada Supreme Court also clearly held that “the NDOI has exclusive
27 original jurisdiction over . . . any matter in which . . . a party seeks to ensure compliance with
28 the Insurance Code.” *Id.* at 994. Because the NDOI has exclusive jurisdiction over Nevada

1 Insurance Code regulatory and administrative claims and First National has not pled that it
 2 exhausted its administrative remedies, there is no cause of action for which relief can be
 3 granted and this claim must be dismissed. *See also Engel v. Hartford Ins. Co. of the Midwest*,
 4 2011 WL 6131566, at *4 (D. Nev. 2011); *Brown v. State Farm Fire & Cas. Co.*, 2011 WL
 5 2295162, at *2 (D. Nev. 2011).

6 **4. Fraud and Concealment**

7 First National alleges in its fourth cause of action that Progressive fraudulently stated
 8 that First National could only receive the benefit of the D&O Policy if a lawsuit against the bank
 9 was filed. (First Am. Compl. (#22) at 13-16). First National also claims that Progressive
 10 engaged in fraud because Elkins misrepresented in his April 4, 2011 letter that the entire Bond
 11 was not payable due to a “material misrepresentation” made on First National’s renewal
 12 application.² (*Id.* at 15).

13 Under Nevada law, a claim of fraudulent misrepresentation requires the plaintiff to
 14 establish each of the following elements: (1) a false representation; (2) knowledge or belief
 15 that the representation was false (or knowledge that the defendant’s basis for making the
 16 representation was insufficient); (3) intent to induce the plaintiff to act or refrain from acting;
 17 (4) justifiable reliance upon the misrepresentation; and (5) damage resulting from such
 18 reliance. *J.A. Jones Constr. Co. v. Lehrer McGovern Bovis, Inc.*, 89 P.3d 1009, 1018 (Nev.
 19 2004). Pursuant to Rule 9(b), a party alleging fraud “must state with particularity the
 20 circumstances constituting fraud or mistake.” To satisfy this standard, a plaintiff must plead
 21 “an account of the ‘time, place, and specific content of the false representations as well as the
 22 identities of the parties to the misrepresentations.’” *Swartz v. KPMG LLP*, 476 F.3d 756, 764

23
 24 ² Progressive contends that First National’s claims for fraud and negligence are barred
 25 by the economic loss doctrine. (Mot. to Dismiss & Strike (#23) at 10-11). However, the
 26 doctrine does not apply to intentional torts, such as fraud. *Terracon Consultants Western, Inc.*
 27 *v. Mandalay Resort Grp.*, 206 P.3d 81, 86 (Nev. 2009); *see also Giles v. Gen. Motors*
 28 *Acceptance Corp.*, 494 F.3d 865, 879 (9th Cir. 2007) (interpreting Nevada law and holding that
 claims for fraud and conversion are not barred by the economic loss doctrine). An exception
 to the economic loss doctrine also exists for negligent misrepresentation claims. *Terracon*,
 206 P.3d at 87. As the majority of First National’s claims for negligence are in actuality claims
 of negligent misrepresentation, the economic loss doctrine would not apply to these claims.

1 (9th Cir. 2007) (quoting *Edwards v. Marin Park, Inc.*, 356 F.3d 1058, 1066 (9th Cir. 2004)).

2 First National first alleges that Elkins misrepresented to Gianoli and Graber of First
3 National on September 28, 2010 that benefits would not be paid under the D&O Policy unless
4 a lawsuit was filed against the bank as a result of Marich's wrongful conduct. (First Am.
5 Compl. (#22) at 11-12). Elkins again made these same representations to Graber on May 13,
6 2010 and in May 2011, and to Gianoli again sometime in September 2010. (*Id.* at 12). First
7 National alleges that these statements were false because the D&O Policy defines a claim as
8 "a written or oral demand for monetary damages or non-monetary relief" in addition to a civil
9 or criminal proceeding. (D&O Policy (#23-3) at 7).

10 Although First National has alleged false representations were made, First National has
11 failed to properly plead that it relied on these misrepresentations and suffered damages from
12 such reliance. First National has failed to identify a single action taken or that it refrained from
13 taking due to the misrepresentations. First National has also failed to identify any damages
14 it suffered by relying on the misrepresentations. Accordingly, the first amended complaint fails
15 to sufficiently plead a claim of fraud based on the alleged fraudulent statements.

16 First National also claims that Progressive engaged in fraud because Elkins
17 misrepresented in his April 4, 2011 letter that the entire Bond was not payable due to a
18 "material misrepresentation" made on First National's renewal application. (First Am. Compl.
19 (#22) at 15). The first amended complaint however fails to identify the purported "material
20 misrepresentation" which disqualified First National from receiving the full value of the Bond
21 or describe how this assertion was in fact false. First National has not alleged that Progressive
22 knew or should have known that they had no right to deny partial payment of the Bond based
23 on the alleged misrepresentation. Finally, First National has failed to plead how it relied on this
24 misrepresentation and was damaged thereby. First National has consequently failed to
25 sufficiently state a claim for fraud.

26 **5. Negligence**

27 In First National's fifth and final cause of action, it alleges that Progressive was
28 negligent because it: (1) misrepresented or concealed the true nature of the policies; (2)

1 created a false basis to delay and/or deny First National's claims; (3) misrepresented or
2 concealed its motivation in denying or partially paying the claims; (4) implemented a training
3 and incentive program to deprive First National of its contractual benefits; and (5) failed to
4 comply with applicable laws for the adjustment of First National's claim. (First Am. Compl.
5 (#22) at 16-17).

6 The first three allegations of negligence appear to allege claims of negligent
7 misrepresentation. To state a claim for negligent misrepresentation, a plaintiff must allege:
8 (1) a representation that is false; (2) that the representation was made in the course of the
9 defendant's business or in any action in which he has a pecuniary interest; (3) the
10 representation was for the guidance of others in their business transactions; (4) the
11 representation was justifiably relied upon; (5) that such reliance resulted in pecuniary loss to
12 the relying party; and (6) that the defendant failed to exercise reasonable care or competence
13 in obtaining or communicating the information. *G.K. Las Vegas Ltd. P'ship v. Simon Prop.*
14 *Grp., Inc.*, 460 F.Supp.2d 1246, 1262 (D. Nev. 2006). First National however has failed to
15 state a claim for negligent misrepresentation because it has not sufficiently pled that it relied
16 on any of the misrepresentations to its detriment. First National has not described any action
17 taken or any action it refrained from taking in reliance on the statements, nor has it identified
18 any pecuniary loss suffered by relying on the statements. Accordingly, First National has
19 failed to state a claim for negligent misrepresentation.

20 As for the allegation that Progressive was negligent because it implemented a training
21 and incentive program to deprive First National of its contractual benefits, First National has
22 provided absolutely no factual support for this claim. The first amended complaint is
23 completely devoid of any allegations that Progressive's training program was improperly
24 conducted or that any incentive program was in place which encouraged employees to deprive
25 others of contractual benefits. As First National has failed to offer any facts from which the
26 Court may draw the reasonable inference that Progressive is liable for the misconduct alleged,
27 this claim should be dismissed.

28 First National's final allegation that Progressive was negligent because it failed to

1 comply with applicable laws for the adjustment of First National's claim should also be
2 dismissed. This claim is duplicative of First National's claim for violation of the Nevada Unfair
3 Claims Settlement Practices Act. First National has already alleged in count three that
4 Progressive violated the Unfair Claims Settlement Practices Act. (First Am. Compl. (#22) at
5 10-13). By alleging that Progressive was negligent because it violated the Unfair Claims
6 Settlement Practices Act, First National is simply attempting to recast a claim for a statutory
7 violation as a negligence claim. As this claim is merely cloaked as a negligence claim but is
8 in substance a duplicative claim for violation of the Unfair Settlement Practices Act, this claim
9 shall be dismissed.

10 **C. Motion to Strike Certain Relief Requested**

11 Progressive also seeks to strike First National's request for punitive damages because
12 First National has failed to plead sufficient facts demonstrating such relief is warranted. (Mot.
13 to Dismiss & Strike (#23) at 15-16). Nevada law authorizes an award of punitive damages "for
14 the breach of an obligation not arising from contract, where . . . the defendant has been guilty
15 of oppression, fraud or malice, express or implied." NEV. REV. STAT. § 42.005(1). Oppression
16 is defined as conduct that subjects a person to cruel and unjust hardship with conscious
17 disregard for the rights of the person. *Id.* § 42.001(4). Malice is defined as "conduct which is
18 intended to injure a person or despicable conduct which is engaged in with a conscious
19 disregard of the rights or safety of others." *Id.* § 42.001(3). A claim for punitive damages
20 requires that the defendant acted with a culpable state of mind and that the conduct exceed
21 mere recklessness or gross negligence. *Countrywide Home Loans, Inc. v. Thitchener*, 192
22 P.3d 243, 255 (Nev. 2008).

23 First National has not sufficiently pled that Progressive was guilty of oppression, fraud,
24 or malice to support a claim for punitive damages. First National failed to allege any facts
25 indicating that Progressive acted fraudulently or consciously disregarded the rights of or acted
26 with the intent of injuring First National. The first amended complaint merely recites the
27 elements of a claim for punitive damages by alleging Progressive acted "fraudulently,
28 oppressively, and with conscious disregard for the rights of Plaintiff." (First Am. Compl. (#22)

at 13). Yet this formulaic recitation of the elements for punitive relief devoid of further factual enhancement is insufficient. *Iqbal*, 556 U.S. at 678. Although the first amended complaint does allege that Progressive delayed in investigating the matter and did not pay the full amount due under the Bond, First National has not pled facts that would suggest these actions were taken with a culpable state of mind exceeding recklessness or gross negligence. Therefore, First National has failed to sufficiently allege that punitive damages are warranted here and that the motion to strike certain relief requested shall be granted.

MOTION TO STRIKE NEW DEFENSES AND LEAVE TO AMEND (#30)

A. Motion to Strike New Defenses

First National has also filed a motion to strike certain defenses put forth by Progressive in its motion to dismiss. First National argues that Progressive is attempting to assert new defenses and justifications for not fully paying under the Bond or the D&O Policy and that it may not offer these new defenses under the “mend the hold” doctrine. (Mot. to Strike & Amend (#30) at 10-15). The “mend the hold” doctrine has never been adopted in Nevada and has not even been alluded to by the Ninth Circuit in over sixty years. The doctrine was first developed by the United States Supreme Court in *Ohio & Mississippi Railway Co. v. McCarthy*, in which the Court held “[w]here a party gives a reason for his conduct and decision touching any thing involved in a controversy, he cannot, after litigation has begun, change his ground, and put his conduct upon another and a different consideration.” 96 U.S. 258, 267-68 (1877). Only a handful of states apply the doctrine and most courts considering the doctrine in recent years have held that it only applies when the offending party changes the initial reason for not performing a contract to a completely different reason in the middle of litigation. See, e.g., *Ryerson Inc. v. Fed. Ins. Co.*, 676 F.3d 610, 614 (7th Cir. 2012); *Burlington Ins. Co., v. PMI America, Inc.*, - - - F.Supp.2d - - - , 2012 WL 995294, at **15-16 (S.D. Ohio Mar. 23, 2012); *Liberty Mut. Ins. Co. v. American Home Assurance Co.*, 858 N.E.2d 530, 539 (Ill. App. Ct. 2006); see also *Harbor Ins. Co. v. Continental Bank Corp.*, 922 F.2d 357, 362-65 (7th Cir. 1990) (providing background on the “mend the hold” doctrine). The doctrine accordingly does not prohibit a party from adding a defense upon being sued or confine him to a defense

1 asserted before the suit was initiated. See *Ryerson Inc.*, 676 F.3d at 614. In addition, the
2 doctrine generally does not apply “in the absence of detriment to the party seeking its
3 application, unfair surprise, or arbitrariness.” *Grinnell Mut. Reinsurance Co. v. LaForge*, 863
4 N.E.2d 1132, 1141 (Ill. App. Ct. 2006).

5 As an initial matter, it is unclear whether Nevada would even accept the “mend the hold”
6 doctrine as it has never been discussed in Nevada case law.³ Yet even if the doctrine was
7 accepted by Nevada, it would not apply here. First, Progressive has not asserted a new
8 defense in the middle of litigation. Progressive stated its reasons for denying coverage under
9 the D&O Policy in its motion to dismiss—the initial pleading filed by Progressive in this
10 Court—and has not changed its defense since the time of that filing. Second, First National
11 has not shown that it would be prejudiced in any way by the assertion of the new defenses and
12 any such prejudice is unlikely as this suit is still in its early stages. Finally, in the Elkins letter
13 explaining why coverage under the D&O Policy was denied, Defendants expressly reserved
14 all rights to raise additional defenses, and thus First National was on notice that additional
15 policy defenses may be raised by Progressive. *Gary G. Day Constr. Co., Inc. v. Clarendon*
16 *America Ins. Co.*, 459 F.Supp.2d 1039, 1050 (D. Nev. 2006) (holding equitable estoppel did
17 not prohibit new defenses from being presented by an insurance company where it had
18 included a reservation of rights in its denial letter). Accordingly, even if Nevada law did accept
19 the “mend the hold” doctrine, the doctrine would not bar the defenses asserted here.

20 First National also attempts to prohibit Progressive’s defenses on the basis of waiver
21 and estoppel. Yet this Court has held that Nevada law “does not allow a litigant to use waiver
22 to extend the coverage or scope of an insurance policy to include claims expressly excluded
23 from the contract” absent evidence of misconduct, such as an “sandbagging,” failing to
24 investigate a claim, or where the insured relied on the insurer’s misrepresentation to her
25 detriment. *Prime Ins. Syndicate, Inc. v. Damaso*, 471 F.Supp.2d 1087, 1098-99 (D. Nev.

27 ³ It appears from the case law that Nevada is more likely to address changes to
28 defenses regarding insurance policies under theories of waiver and estoppel, which are
discussed below.

2007). First National is essentially arguing that because Progressive did not originally assert certain defenses limiting the scope of the policy that they have waived those exclusions, which has the effect of expanding the scope of the policy. Nevada law does not allow such a result. See *id.* The motion to strike new defenses shall be denied.⁴

B. Motion for Leave to File Second Amended Complaint

First National has also requested leave to file a second amended complaint. Under Fed. R. Civ. P. 15(a), the court should freely give leave to amend. However, leave to amend need not be granted when it would result in undue delay, the request was made in bad faith, it would prejudice the opposing party, or amendment would be futile. *Lockheed Martin Corp. v. Network Solutions, Inc.*, 194 F.3d 980, 986 (9th Cir. 1999). A motion to amend a complaint is futile where the motion offers no new set of facts or legal theory, or fails to state a cognizable claim. *Gardner v. Martino*, 563 F.3d 981, 991 (9th Cir. 2009); see also *Miller v. Skogg*, 2011 WL 383948, at *4 (D. Nev. 2011) (denying plaintiff's motion to amend as futile for failure to state a claim under Federal Rule of Civil Procedure 12(b)(6)).

The second amended complaint contains the same five causes of action contained in the original complaint, but merely adds the allegations that John Gianoli was negligent by failing to act on Marich's fraud by not causing cross training, accounting, and auditing to occur which would have prevented the fraud. (Second Am. Compl. (#30-19) at 7). The second amended complaint also alleges that a claim was made against Gianoli under the D&O Policy by one or more shareholders of First National. (*Id.*).

In alleging Gianoli was negligent by failing to monitor and prevent the criminal conduct of Marich, First National is apparently attempting to avoid the Fraud/Violation of Law Exclusion which was fatal to its breach of contract claim in its first amended complaint. However, the exclusion clearly states that Progressive "shall not be liable to make any payment for Loss, other than Defense Costs, in connection with any Claim *arising out of or in any way involving*

⁴ Even though the Court denies the motion to strike new defenses, it is not excluding evidence of changed defenses on the fraud, misrepresentation, and statutory claims in handling causes of action.

1 any fraudulent, dishonest or criminal act.” (D&O Policy (#23-3) at 12) (emphasis added).
2 Although Gianoli may have been negligent in monitoring Marich, that does not change the fact
3 that the underlying cause of the loss was a fraudulent and criminal act. Because the loss
4 arose out of a fraudulent and criminal act, the Fraud/Violation of Law Exclusion still applies.⁵
5 Furthermore, allowing First National to recast the loss suffered from fraud as a claim of
6 negligence against the supervisor of the criminal actor would effectively eliminate the exclusion
7 altogether because whenever an employee commits a fraudulent/criminal act, allegations
8 framed in negligence can always be made against the employee’s supervisor. Accordingly,
9 First National’s attempt to amend its first amended complaint to collect under the D&O Policy
10 through Gianoli’s negligence fails.

11 First National also attempts to amend its complaint by alleging that shareholders have
12 made a claim against Gianoli under the D&O Policy. (Second Am. Compl. (#30-19) at 7). By
13 doing so, First National is attempting to obtain coverage under the D&O Policy’s insured
14 persons liability coverage. The clause for insured persons liability coverage states that
15 Progressive “will pay on behalf of the Insured Persons, Loss resulting from Claims first made
16 during the Policy Period or the Discovery Period against the Insured Persons for which the
17 Insured Persons are legally obligated to pay for Wrongful Acts, except for Loss the Company
18 pays as indemnification.” (D&O Policy (#23-3) at 5). The Court grants First National leave to
19 amend to allege Gianoli’s liability as a basis for the indemnification claims. As such, the
20 motion for leave to file a second amended complaint is granted in part and denied in part.

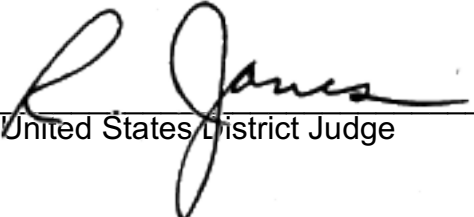
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22
23 ⁵ First National contends that Marich’s fraudulent and criminal conduct cannot be
24 imputed to Gianoli under the D&O Policy because the Severability of Exclusions Clause in the
25 policy provides that “no Wrongful Act . . . by any Insured Person will be imputed to any other
26 Insured Person.” (D&O Policy (#23-3) at 21). Yet the term “Wrongful Act” is a defined term
27 which nowhere appears in the Fraud/Violation of Law Exclusion. The Fraud/Violation of Law
28 Exclusion only excludes claims for losses suffered through fraudulent, dishonest or criminal
acts—not “Wrongful Acts” as defined. (*Id.* at 12). The actions addressed in the
Fraud/Violation of Law Exclusion are therefore not “Wrongful Acts,” but rather separate and
distinct conduct not applicable to the term. As the actions prohibited by the Fraud/Violation
of Law Exclusion are not “Wrongful Acts,” the Severability of Exclusions Clause does not
require that the fraudulent acts of Marich be severable from the negligent actions of Gianoli.

CONCLUSION

For the foregoing reasons, IT IS ORDERED that the motion to dismiss and to strike certain relief requested (#23) is **GRANTED IN PART AND DENIED IN PART** as follows: the motion to dismiss is granted with respect to the claims for breach of the D&O Policy (contained in count one), violations of Chapter 686A of the Nevada Administrative Code (contained in count three), fraud and concealment (count four), and negligence (count five), without leave to amend, and denied with respect to the claims of breach of the Bond (contained in count one), breach of the covenant of good faith and fair dealing (count two), and violation of Nevada's Unfair Claims Settlement Practices Act, NRS §§ 686A.310(1)(a)-(e), (contained in count three). The request to strike certain relief is granted.

IT IS FURTHER ORDERED that the motion to strike certain new defenses raised and for leave to file second amended complaint raised (#30) is **GRANTED IN PART AND DENIED IN PART**. The motion to strike certain defenses is denied. The motion to amend is granted in part.

DATED: This 26TH day of November, 2012.


United States District Judge